



[4830-01-p]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 9862]

RIN 1545-BO01

Certain Transfers of Property to Regulated Investment Companies [RICs] and Real Estate Investment Trusts [REITs]

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations and removal of temporary regulations.

SUMMARY: This document contains final regulations effecting the repeal of the General Utilities doctrine by the Tax Reform Act of 1986 and preventing abuse of the Protecting Americans from Tax Hikes Act of 2015 (PATH Act). The final regulations impose corporate-level tax on certain transactions in which property of a C corporation becomes the property of a REIT. The final regulations affect RICs, REITs, C corporations the property of which becomes the property of a RIC or a REIT, and their shareholders.

DATES: Effective Date: These regulations are effective on **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**.

Applicability Dates: For dates of applicability, see §1.337(d)-7(g)(2)(ii).

FOR FURTHER INFORMATION CONTACT: Austin Diamond-Jones, (202) 317-5363 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains amendments to 26 CFR part 1 under section 337(d) of the Internal Revenue Code (Code).

In General Utilities & Operating Co. v. Helvering, 296 U.S. 200 (1935), the Supreme Court held that corporations generally could distribute appreciated property to their shareholders without the recognition of any corporate-level gain (General Utilities doctrine). Beginning with legislation in 1969 and culminating in the Tax Reform Act of 1986, Public Law 99-514 (100 Stat. 2085), Congress repealed the General Utilities doctrine by enacting section 336(a) to apply gain and loss recognition to liquidating distributions. Section 337(d) directs the Secretary of the Treasury (Secretary) to prescribe regulations that are necessary or appropriate to carry out the purposes of General Utilities repeal, including “regulations to ensure that such purposes may not be circumvented through the use of any provision of law or regulations (including . . . part III of this subchapter) or through the use of a regulated investment company, real estate investment trust, or tax exempt entity. . . .”

On June 8, 2016, the Department of the Treasury (Treasury Department) and the IRS published temporary regulations (TD 9770) under section 337(d) (Temporary Regulations) in the **Federal Register** (81 FR 36793) effecting the repeal of the General Utilities doctrine as applied to certain transfers of property to RICs and REITs. A notice of proposed rulemaking (REG-126452-15) was published in the **Federal Register** (81 FR 36816) on the same day (2016 Proposed Regulations). The text of the Temporary Regulations served as the text for part of the 2016 Proposed Regulations, which also included an amendment not included in the Temporary Regulations. A correction to the

Temporary Regulations was published in the **Federal Register** (81 FR 41800) on June 28, 2016.

In response to the 2016 Proposed Regulations, the Treasury Department and the IRS received one written comment and a letter addressed to the Secretary by the Chairmen and Ranking Members of the Ways and Means Committee of the U.S. House of Representatives and the Finance Committee of the U.S. Senate (Letter). The comment requested a public hearing, which was held on November 9, 2016.

After consideration of the written comment, the Letter, and comments made at the public hearing, the Treasury Department and the IRS adopted the 2016 Proposed Regulations, in part, in final regulations (TD 9810) published in the **Federal Register** (82 FR 5387) on January 18, 2017 (2017 Final Regulations). The 2017 Final Regulations adopted a definition of the term “recognition period” consistent with the definition used in section 1374(d), regarding S corporations, and amended and removed corresponding provisions in the Temporary Regulations. The preamble to the 2017 Final Regulations indicated that the Treasury Department and the IRS would continue to study other issues addressed in the Temporary Regulations and the 2016 Proposed Regulations.

Executive Order 13789 (E.O. 13789), issued on April 21, 2017, instructed the Secretary to review all significant tax regulations issued on or after January 1, 2016, and to take concrete action to alleviate the burdens of regulations that (i) impose an undue financial burden on U.S. taxpayers; (ii) add undue complexity to the Federal tax laws; or (iii) exceed the statutory authority of the IRS. E.O. 13789 further instructed the

Secretary to submit to the President within 60 days an interim report identifying regulations that meet these criteria.

Notice 2017-38 (2017-30 I.R.B. 147 (July 24, 2017)) included the Temporary Regulations in a list of eight regulations identified by the Secretary in the interim report as meeting at least one of the first two criteria specified in E.O. 13789. In particular, Notice 2017-38 mentioned a concern raised by commenters that the Temporary Regulations “could result in over-inclusion of gain in some cases, particularly where a large corporation acquires a small corporation that engaged in a Section 355 spinoff and the large corporation subsequently makes a REIT election.” See also Executive Order 13789--Second Report to the President on Identifying and Reducing Tax Regulatory Burdens (Second Report), 82 FR 48013 (October 16, 2017) (stating that the Treasury Department and the IRS “agree that the temporary regulations may produce inappropriate results in some cases”). In response to comments received addressing the Temporary Regulations and the 2016 Proposed Regulations, the Treasury Department and the IRS published a notice of proposed rulemaking (REG-113943-17) addressing the potential over-inclusion of gain in the **Federal Register** (84 FR 11259) on March 26, 2019 (2019 Proposed Regulations). A correction to the 2019 Proposed Regulations was published in the **Federal Register** (84 FR 18999) on May 3, 2019. One substantive comment was received in response to the 2019 Proposed Regulations.

Summary of Comments and Explanation of Revisions

This Summary of Comments and Explanation of Revisions discusses the comments received in response to the 2016 Proposed Regulations, Notice 2017-38, and the 2019 Proposed Regulations. However, certain comments received in response

to the 2016 Proposed Regulations and Notice 2017-38 were addressed in the Explanation of Provisions in the preamble to the 2019 Proposed Regulations and are not repeated in this Summary of Comments and Explanation of Revisions.

I. Consideration of Limitation for Planned Transactions

Under proposed §1.337(d)-7(c)(6), a C corporation described in paragraph (f)(1) of that section would be treated as having made an election under §1.337(d)-7(c)(5) (deemed sale election) with respect to a conversion transaction if (i) the conversion transaction occurs following a related section 355 distribution (as defined in paragraph (f)(1)(i) of that section), and (ii) the C corporation has not made such election (automatic deemed sale rule). Proposed §1.337(d)-7(f)(1) would provide that the automatic deemed sale rule (or the corresponding rule in paragraph (b)(4) of that section) applies to a C corporation if (i) the C corporation engages in a conversion transaction involving a REIT during the twenty-year period beginning on the date that is ten years before the date of a related section 355 distribution and (ii) the C corporation engaging in the related section 355 distribution is either the distributing corporation or the controlled corporation (as those terms are defined in section 355(a)(1)), or a member of the separate affiliated group (as defined in section 355(b)(3)(B)) (SAG) of the distributing corporation or the controlled corporation. A conversion transaction occurs through (i) the qualification of a C corporation as a RIC or a REIT, or (ii) the transfer of property owned by a C corporation to a RIC or a REIT. Section 1.337(d)-7(a)(2)(ii).

One commenter recommended that the automatic deemed sale rule apply only if the conversion transaction and the related section 355 distribution are carried out as part of the same plan. To facilitate the identification of such a plan, the commenter

requested a two-year presumption rule. Under that rule, (i) a conversion transaction completed within two years of a related section 355 distribution would be presumed to have been carried out as part of a plan that included the related section 355 distribution, and (ii) a conversion transaction not completed within two years of a related section 355 distribution would be presumed not to have been carried out as part of such a plan. The commenter also recommended additional provisions similar to the section 355(e) safe harbor rules and the section 707(a)(2)(B) disguised sale rules.

The Treasury Department and the IRS agree that the automatic deemed sale rule could apply to a conversion transaction and related section 355 distribution carried out as part of the same plan, but they have determined that the text and purposes of sections 355(h) and 856(c)(8) do not require the existence of a plan. Those provisions, as added by section 311 of the PATH Act, enacted as Division Q of the Consolidated Appropriations Act, 2016, Public Law 114-113 (129 Stat. 2422), prevent the circumvention of General Utilities repeal and apply without regard to the existence of a plan that includes both a related section 355 distribution and a conversion transaction. Under section 355(h), a distribution of the stock of a controlled corporation does not qualify for tax-free treatment under section 355(a) if either the distributing corporation or the controlled corporation (but not both) is a REIT. The section 856(c)(8) limitation on eligibility for REIT elections focuses on the ten-year period (rather than a two-year period) beginning on the date of a distribution to which section 355 (or so much of section 356 as relates to section 355) applies. In addition, the Treasury Department and the IRS have determined that the introduction of a plan concept (as well as the recommended safe harbor and anti-abuse rules) into the automatic deemed sale rule

would substantially increase the rule's complexity, and thereby reduce its effectiveness and predictability.

II. Time Period between Conversion Transaction and Related Section 355 Distribution

As described in part I of this Summary of Comments and Explanation of Revisions, application of the automatic deemed sale rule depends in part on whether a C corporation engages in a conversion transaction involving a REIT during the twenty-year period beginning on the date that is ten years before the date of a related section 355 distribution. See proposed §1.337(d)-7(c)(6). A commenter requested that these final regulations reduce that twenty-year period to a ten-year period. The commenter relied upon §1.337(d)-7(b)(2)(iii), which incorporates the five-year recognition period described in section 1374(d)(7)(A) specifically for purposes of applying the rules of section 1374 and the regulations thereunder. The commenter noted that the PATH Act had reduced the ten-year period historically required under section 1374(d)(7)(A) to the current five-year period, and asserted that the automatic deemed sale rule should employ a five-year recognition period, both before and after a related section 355 distribution, to maintain consistency with the recognition rules specific to section 1374.

The Treasury Department and the IRS recognize the commenter's preference for consistency. However, they have concluded that section 1374 treatment does not adequately implement the purposes of General Utilities repeal if a taxpayer effects a tax-free separation of REIT-qualifying assets from non-qualifying assets in a section 355 distribution and the REIT-qualifying assets become the assets of a REIT. See preamble to the Temporary Regulations (81 FR at 36795). As an example, the REIT and its shareholders may realize the benefit of appreciation on converted property without a

transaction that is taxable at the corporate level. See id. at 36795-6. Moreover, without a section 355 distribution, a taxpayer generally could not separate REIT-qualifying assets from non-qualifying assets and cause one corporation to hold the REIT-qualifying assets and another corporation to hold the non-qualifying assets except by means of a taxable transaction. See id. at 36796. Consequently, the Treasury Department and the IRS have concluded that a five-year recognition period provided specifically for section 1374 and its underlying regulations should not affect the length of the recognition period for the automatic deemed sale rule.

The Treasury Department and the IRS have concluded that the ten-year eligibility limitation regarding REIT elections under section 856(c)(8) provides a more appropriate safeguard for General Utilities repeal, and supports the twenty-year recognition period in proposed §1.337(d)-7(f)(1)(i). In general, section 856(c)(8) provides that a corporation may not elect REIT status during the ten-year period following a distribution qualifying under section 355 if such corporation was the distributing corporation or the controlled corporation in that distribution. When describing existing law prior to the enactment of section 856(c)(8), the staff of the Joint Committee on Taxation observed that, following a section 355 distribution, “income from the assets held in the REIT is no longer subject to corporate level tax (unless there is a disposition of such assets that incurs tax under the built in gain rules).” See Staff, Joint Committee on Taxation, Technical Explanation of the Protecting Americans from Tax Hikes Act of 2015, House Amendment #2 to the Senate Amendment to H.R. 2029, JCX-144-15, at 170 (2015). Consequently, to ensure the continuing integrity of General Utilities repeal, the Treasury

Department and the IRS have concluded that the twenty-year period described in proposed §1.337(d)-7(f)(1)(i) would provide a more appropriate recognition period.

III. Application of Automatic Deemed Sale Rule to Predecessors and Successors

Proposed §1.337(d)-7(f)(2) would provide that, for purposes of identifying C corporations to which the automatic deemed sale rule could apply, “any reference to a controlled corporation or a distributing corporation includes a reference to any predecessor or successor of such corporation.” The terms “predecessor” and “successor” would “include corporations which succeed to and take into account items described in section 381(c) of the distributing corporation or the controlled corporation, and corporations having such items to which the distributing corporation or the controlled corporation succeeded and took into account.” Proposed §1.337(d)-7(f)(2). Commenters have expressed concern that the word “include” will create uncertainty regarding the scope of the terms “predecessor” and “successor” and consequently would cause difficulties in performing due diligence. As a result, these commenters have requested that the word “include” be clarified or otherwise limited.

The Treasury Department and the IRS acknowledge these concerns, particularly those regarding due diligence burdens, but have determined that proposed §1.337(d)-7(f)(2) strikes an appropriate balance between providing sufficiently predictable application of the automatic deemed sale rule and preventing avoidance of that rule. The application of predecessor and successor concepts to distributing corporations and controlled corporations in the 2016 Proposed Regulations, extended to members of the SAGs of those corporations in the 2019 Proposed Regulations, limits the potential avoidance of the automatic deemed sale rule. The Treasury Department and the IRS

have determined that the language of proposed §1.337(d)-7(f)(2) will provide sufficient certainty regarding the scope of the terms “predecessor” and “successor,” particularly in light of the 2019 Proposed Regulations’ policy of ensuring that gain will be recognized “only on property that is traceable to the section 355 distribution.” Preamble to 2019 Proposed Regulations (84 FR 11261). Moreover, the distribution property limitation will reduce uncertainty as to the consequences of a determination that a corporation is a predecessor or successor.

IV. Application to SAG Members of Distributing and Controlled Corporations

One commenter contended that the 2016 Proposed Regulations should not apply to a member of the SAG of the distributing corporation or the controlled corporation because corporate-level taxation would not be avoided in such a situation unless the stock of the SAG member itself were distributed in a section 355 distribution. The Treasury Department and the IRS have determined that corporate-level taxation could be avoided regardless of whether the stock of the SAG member were distributed.

As an example, a distributing corporation owns all of the stock of a controlled corporation, the sole assets of which consist of all of the stock in a subsidiary that owns only real estate assets. The distributing corporation distributes all of the controlled corporation stock in a distribution qualifying under section 355. Within ten years thereafter, the subsidiary elects REIT status. During the year following the election, the controlled corporation merges downstream into the subsidiary in a reorganization described in section 368(a), with the subsidiary surviving. Section 856(c)(8) would not apply to that transaction because the subsidiary was not a distributing corporation, a controlled corporation, or a successor to either corporation at the time of the REIT

election (although the subsidiary subsequently becomes a successor to the controlled corporation as a result of the merger). Accordingly, the Treasury Department and the IRS have determined that the application of the automatic deemed sale rule to SAG members of the distributing corporation or a controlled corporation would further the intent of Congress to prevent avoidance of General Utilities repeal.

V. Scope of, and Exclusions to, the Automatic Deemed Sale Rule

A. *Two-Year Requirement for Post-Distribution Distributing and Controlled REITs*

Proposed §1.337(d)-7(f)(3)(i) would preclude application of the automatic deemed sale rule if the distributing corporation and the controlled corporation are both REITs immediately after the related section 355 distribution and at all times during the two-year period thereafter. Commenters have requested the elimination of the two-year requirement.

The Treasury Department and the IRS have concluded, however, that the two-year requirement would appropriately limit potential avoidance of proposed §1.337(d)-7(f)(3)(i). The two-year requirement is designed to protect the purposes of the PATH Act, and therefore General Utilities repeal, by ensuring that distributing corporations and controlled corporations that pursue the exception provided by section 355(h)(2)(A) continue to operate for a substantial duration as REITs. The Treasury Department and the IRS acknowledge concerns raised by commenters regarding the risk of inadvertent terminations of REIT status during this initial two-year period. However, section 856 provides opportunities for a REIT to cure an inadvertent technical failure to comply with that section's requirements without loss of REIT status. See, for example, sections 856(c)(6), (c)(7), and (g)(5) (election of REIT status terminates for failure to meet REIT

requirements unless failure is due to reasonable cause and not due to willful neglect). Consequently, the Treasury Department and the IRS do not believe that the two-year requirement would cause the distributing corporation or the controlled corporation to recognize gain as a result of inadvertent noncompliance.

B. Consideration of Exclusion Involving REITs and Qualified REIT Subsidiaries

A commenter requested that the automatic deemed sale rule not apply to certain section 355 distributions within corporate groups, after which the corporate parent of the distributing corporation and the controlled corporation elects REIT status, and the distributing corporation, the controlled corporation, or both become qualified REIT subsidiaries (QRS).

The Treasury Department and the IRS decline to adopt this proposed exception to the automatic deemed sale rule based on the determination that such exception would create opportunities for circumventing General Utilities repeal. For example, a section 355 distribution of a controlled corporation that will be a QRS following the parent's election of REIT status could be used to reduce the value of the distributing corporation in order for such corporation to be a taxable REIT subsidiary following its parent's election of REIT status, even though, without such a reduction, the value of the distributing corporation would cause the parent to fail the requirement of section 856(c)(4)(B)(ii). In addition, the Treasury Department and the IRS note that, if the distributing corporation or the controlled corporation had liquidated (or had been deemed to liquidate) prior to the parent's REIT election, the parent would be a successor to the liquidated corporation and therefore ineligible to elect REIT status as a result of section 856(c)(8).

C. Consideration of Knowledge Standard for Automatic Deemed Sale Rule

A commenter requested the incorporation of a knowledge standard into the automatic deemed sale rule. Specifically, the commenter recommended that the automatic deemed sale rule should not apply to a REIT that receives property from a C corporation if the REIT (i) receives a representation that the C corporation (including specified predecessors and SAG members) has not engaged in a related section 355 distribution, and (ii) has no actual knowledge contrary to such representation. The commenter contended that, without a knowledge component, the level of diligence necessary to apply the automatic deemed sale rule could prove burdensome (for example, in situations that involve predecessors of SAG members or significant time lapses between relevant transactions). For similar reasons, the commenter asserted that the absence of a knowledge component could limit the practical utility of the distribution property limitation under proposed §1.337(d)-7(c)(6)(ii), which would require the REIT to establish through such diligence that a subject property is not distribution property.

The Treasury Department and the IRS acknowledge the concerns expressed by the commenter, but have decided not to adopt this recommendation. The Treasury Department and the IRS have concluded that adoption of a knowledge component would reduce, rather than increase, certainty regarding the application of the automatic deemed sale rule because a knowledge component would inject subjectivity into the rule. Moreover, as the commenter noted, REITs ordinarily undertake extensive due diligence in connection with corporate transactions, such as mergers with C corporations, to ensure that the transaction will not terminate REIT status. For

example, a REIT would routinely conduct an earnings and profits study of the C corporation. As a result, the Treasury Department and the IRS believe that REITs generally will possess adequate data to determine the appropriate tax consequences of a conversion transaction and make use of the distribution property limitation, particularly because this limitation will apply on a property-by-property basis and thereby apply even if a REIT possesses incomplete records. In addition, a contemporaneous documentation of property owned at the time of a related section 355 distribution generally will provide sufficient records for establishing that any property not listed in such documentation is not distribution property.

VI. Definition of the Term “Converted Property”

The 2016 Proposed Regulations would define the term “converted property” as “property owned by a C corporation that becomes the property of a RIC or a REIT and any other property the basis of which is determined, directly or indirectly, in whole or in part, by reference to the basis of the property owned by a C corporation that becomes the property of a RIC or a REIT.” Proposed §1.337(d)-7(a)(2)(vii). A commenter requested that the definition be clarified to confirm the commenter’s interpretation that the phrase “any other property” refers only to property of a RIC or a REIT. The Treasury Department and the IRS agree with the commenter’s interpretation and have clarified the definition accordingly.

VII. Interaction of 2016 Proposed Regulations with Section 856(c)(8)

A commenter inquired whether the Treasury Department or the IRS intended the 2016 Proposed Regulations to override section 856(c)(8) (described in part I of this Summary of Comments and Explanation of Revisions). The 2016 Proposed

Regulations do not override section 856(c)(8). Accordingly, if section 856(c)(8) would prevent a distributing corporation or a controlled corporation from electing REIT status, no gain would be recognized, absent further action (for example, a merger of the distributing corporation or the controlled corporation into a REIT).

VIII. Application of 2016 Proposed Regulations to RICs

The Treasury Department and the IRS requested comments on whether the rules set forth in the 2016 Proposed Regulations (other than the definition of the term “converted property”) should apply to RICs. No recommendations were received in response to this request. The Treasury Department and the IRS have not become aware of a need to extend the rules to RICs and therefore decline to extend such rules to RICs at this time.

Effective/applicability dates

The 2019 proposed regulations included a proposal to issue the final rule with a 30-day delayed effective date. The Treasury Department and the IRS have concluded, however, that a 30-day delay in the effective date of these final regulations would be unnecessary and contrary to public interest. Specifically, the Treasury Department and the IRS have determined that any duration between the expiration of the Temporary Regulations and the effective date of these final regulations could cause significant confusion regarding the current state of the law. In addition, the Treasury Department and the IRS have concluded that the benefit of public notice ordinarily provided by such 30-day delay is significantly reduced in this particular instance because these final regulations adopt the proposed regulations without substantive change. In addition, the Treasury Department and the IRS note that these final regulations adopt the distribution

property limitation under proposed §1.337(d)-7(c)(6)(ii), which provides an exception to the general automatic deemed sale rule.

Special Analyses

This regulation is not subject to review under section 6(b) of Executive Order 12866 pursuant to the Memorandum of Agreement (April 11, 2018) between the Treasury Department and the Office of Management and Budget regarding review of tax regulations. Pursuant to the Regulatory Flexibility Act (5 U.S.C. chapter 6), it is hereby certified that these final regulations will not have a significant economic impact on a substantial number of small entities. These final regulations would affect transactions in which property of a C corporation becomes the property of a REIT following a section 355 distribution of controlled C corporation stock. Generally, these section 355 distributions involve publicly traded C corporations, which typically are not small entities as defined by the Regulatory Flexibility Act. Transactions in which the property of such C corporation becomes the property of a REIT generally involve the transfer of all of the assets of the C corporation. Therefore, the transferee REIT likely also would not be a small entity, as defined by the Regulatory Flexibility Act. As a result, this certification is based on the conclusion that these final regulations would primarily affect large C corporations and REITs that have substantial numbers of shareholders. Therefore, a regulatory flexibility analysis is not required. Pursuant to section 7805(f) of the Code, the proposed rule preceding this final regulation was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business and no comments were received.

Drafting Information

The principal author of these regulations is Austin Diamond-Jones, Office of Associate Chief Counsel (Corporate). However, other personnel from the Treasury Department and the IRS participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

Part 1--INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.337(d)-7 is amended by:

1. Revising paragraphs (a)(1) and (a)(2)(vi) through (vii).
2. Adding paragraph (a)(2)(viii).
3. Revising paragraphs (b)(4), (c)(1) and (6), (f), and (g)(2)(ii).

The revisions and additions read as follows:

§1.337(d)-7 Tax on property owned by a C corporation that becomes property of a RIC or REIT.

(a) General rule--(1) Property owned by a C corporation that becomes property of a RIC or a REIT. If property owned by a C corporation (as defined in paragraph (a)(2)(i) of this section) becomes the property of a RIC or a REIT in a conversion transaction (as defined in paragraph (a)(2)(ii) of this section), then section 1374 treatment will apply as described in paragraph (b) of this section, unless the C corporation elects, or is treated as electing, deemed sale treatment with respect to the conversion transaction as

provided in paragraph (c) of this section. See paragraph (d) of this section for exceptions to this paragraph (a).

(2) * * *

(vi) Section 355 distribution. The term *section 355 distribution* means any distribution to which section 355 (or so much of section 356 as relates to section 355) applies, including a distribution on which the distributing corporation recognizes gain pursuant to sections 355(d) or 355(e).

(vii) Converted property. The term *converted property* means--

(A) Property owned by a C corporation that becomes the property of a RIC or a REIT; and

(B) Any other property of a RIC or a REIT the basis of which is determined, directly or indirectly, in whole or in part, by reference to the basis of property described in paragraph (a)(2)(vii)(A) of this section.

(viii) Distribution property. The term *distribution property* means--

(A) Property owned immediately after a section 355 distribution by the distributing corporation, a controlled corporation (as those terms are defined in section 355(a)(1)), or a member of a separate affiliated group (as defined in section 355(b)(3)(B)) of which the distributing corporation or a controlled corporation is the common parent (but no formulation of the step transaction doctrine will be used to determine whether property acquired after the distribution is distribution property pursuant to this paragraph (a)(2)(viii)(A)); and

(B) Property with a basis determined, directly or indirectly, in whole or in part, by reference to property described in paragraph (a)(2)(viii)(A) of this section.

(b) * * *

(4) Section 355 distribution following a conversion transaction--(i) In general. If a REIT is described in paragraph (f)(1) of this section and the related section 355 distribution (as defined in paragraph (f)(1)(i) of this section) follows a conversion transaction, then for the taxable year in which the related section 355 distribution occurs, §1.1374-2(a)(1) and (2) (as modified by paragraph (b)(2)(i) of this section) do not apply, and the REIT's net recognized built-in gain for such taxable year is the amount of its net unrealized built-in gain limitation (as defined in §1.1374-2(a)(3)) for such taxable year.

(ii) Basis adjustment--(A) In general. If a REIT recognizes gain under paragraph (b)(4)(i) of this section, the aggregate basis of the converted property held by the REIT at the end of the taxable year in which the related section 355 distribution occurs shall be increased by an amount equal to the amount of gain so recognized, increased by the amount of the REIT's recognized built-in loss for such taxable year, and reduced by the amount of the REIT's recognized built-in gain and recognized built-in gain carryover for such taxable year.

(B) Allocation of basis increase. The aggregate increase in basis by reason of paragraph (b)(4)(ii)(A) of this section shall be allocated among the converted property in proportion to their respective built-in gains on the date of the conversion transaction.

* * * * *

(c) Election of deemed sale treatment--(1) In general. Paragraph (b) of this section does not apply if the C corporation that qualifies as a RIC or a REIT or transfers property to a RIC or a REIT makes the election described in paragraph (c)(5) of this

section or is treated as making such election under paragraph (c)(6) of this section, except to the extent permitted by paragraph (c)(6)(ii) of this section. A C corporation that makes, or that is treated as making, such an election recognizes gain and loss as if it sold the converted property to an unrelated party at fair market value on the deemed sale date (as defined in paragraph (c)(3) of this section). See paragraph (c)(4) of this section concerning limitations on the use of loss in computing gain. Paragraph (c) of this section does not apply if its application would result in the recognition of a net loss. For this purpose, net loss is the excess of aggregate losses over aggregate gains (including items of income), without regard to character.

* * * * *

(6) Conversion transaction following a section 355 distribution--(i) In general. Except as provided in paragraph (c)(6)(ii) of this section, a C corporation described in paragraph (f)(1) of this section is treated as having made the election under paragraph (c)(5) of this section with respect to a conversion transaction if the conversion transaction occurs following the related section 355 distribution (as defined in paragraph (f)(1)(i) of this section) and the C corporation has not made such an election.

(ii) Limitation. A C corporation treated as having made the election under paragraph (c)(5) of this section as a result of paragraph (c)(6)(i) of this section is not treated as having made the election with respect to property that the taxpayer establishes is not distribution property with respect to the related section 355 distribution. For purposes of this paragraph (c)(6)(ii), any property with an adjusted basis in excess of its fair market value as of the date of the conversion transaction will not be treated as distribution property unless the taxpayer establishes that it owned

such asset immediately after the related section 355 distribution. Paragraph (b) of this section will apply to property with respect to which the taxpayer is not treated as having made the election under paragraph (c)(5) of this section as a result of this paragraph (c)(6)(ii).

* * * * *

(f) Conversion transaction preceding or following a section 355 distribution--(1) In general. A C corporation or a REIT is described in this paragraph (f)(1) if--

(i) The C corporation or the REIT engages in a conversion transaction involving a REIT during the twenty-year period beginning on the date that is ten years before the date of a section 355 distribution (the *related section 355 distribution*); and

(ii) The C corporation or the REIT engaging in the related section 355 distribution is either--

(A) The distributing corporation or the controlled corporation, as those terms are defined in section 355(a)(1); or

(B) A member of the separate affiliated group (as defined in section 355(b)(3)(B)) of the distributing corporation or the controlled corporation.

(2) Predecessors and successors. For purposes of this paragraph (f), any reference to a controlled corporation, a distributing corporation, or a member of the separate affiliated group of a distributing corporation or a controlled corporation includes a reference to any predecessor or successor of such corporation. Successors include corporations which succeed to and take into account items described in section 381(c) of the distributing corporation or the controlled corporation. Predecessors include

corporations having such items to which the distributing corporation or the controlled corporation succeeded and took into account.

(3) Exclusion of certain conversion transactions. A C corporation or a REIT is not described in paragraph (f)(1) of this section if--

(i) The distributing corporation and the controlled corporation are both REITs immediately after the related section 355 distribution (including by reason of elections under section 856(c)(1) made after the related section 355 distribution that are effective before the related section 355 distribution) and at all times during the two years thereafter;

(ii) Section 355(h)(1) does not apply to the related section 355 distribution by reason of section 355(h)(2)(B); or

(iii) The related section 355 distribution occurred before December 7, 2015, or is described in a ruling request referred to in section 311(c) of Division Q of the Consolidated Appropriations Act, 2016, Public Law 114-113, 129 Stat. 2422.

(g) * * *

(2) * * *

(ii) Conversion transactions occurring on or after June 7, 2019, and certain prior conversion transactions. Paragraphs (a)(1), (a)(2)(vi), (vii), and (viii), (b)(4), (c)(1) and (6), and (f) of this section apply to conversion transactions occurring on or after June 7, 2019, and to conversion transactions and related section 355 distributions for which the conversion transaction occurs before, and the related section 355 distribution occurs on or after, June 7, 2019. For conversion transactions that occurred on or after June 7, 2016, and before June 7, 2019 (other than conversion transactions and related section

355 distributions for which the conversion transaction occurs before, and the related section 355 distribution occurs on or after, June 7, 2019), see §§1.337(d)-7 and 1.337(d)-7T as contained in 26 CFR part 1 in effect on April 1, 2019.

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§1.337(d)-7T [Removed]

Par. 3. Section 1.337(d)-7T is removed.

Kirsten Wielobob,

Deputy Commissioner for Services and Enforcement.

Approved: May 29, 2019.

David J. Kautter,

Assistant Secretary of the Treasury (Tax Policy).

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